

VZCZCXRO8575  
RR RUEHRG  
DE RUEHSO #0688/01 3291415  
ZNR UUUUU ZZH  
R 251414Z NOV 09  
FM AMCONSUL SAO PAULO  
TO RUEHC/SECSTATE WASHDC 0223  
INFO RHEBAAA/DEPT OF ENERGY WASHINGTON DC  
RHEHNSC/WHITE HOUSE NATIONAL SECURITY COUNCIL WASHINGTON DC  
RUEHAC/AMEMBASSY ASUNCION  
RUEHBO/AMEMBASSY BOGOTA  
RUEHBR/AMEMBASSY BRASILIA 0237  
RUEHBU/AMEMBASSY BUENOS AIRES  
RUEHCV/AMEMBASSY CARACAS  
RUEHLP/AMEMBASSY LA PAZ  
RUEHMN/AMEMBASSY MONTEVIDEO  
RUEHPE/AMEMBASSY LIMA  
RUEHRG/AMCONSUL RECIFE 0038  
RUEHRI/AMCONSUL RIO DE JANEIRO  
RUEHSG/AMEMBASSY SANTIAGO  
RUEHSO/AMCONSUL SAO PAULO

UNCLAS SECTION 01 OF 03 SAO PAULO 000688

SENSITIVE  
SIPDIS  
STATE PASS USTR FOR KKALUTKIEWIECZ  
STATE PASS NSC RWALSH  
STATE PASS DOE RROTH  
WHA/EPSC  
EEB/ESC/IEC

E.O. 12958: N/A

TAGS: [ECON](#) [ENRG](#) [EFIN](#) [PGOV](#) [BR](#) [ETRD](#) [EINV](#)

SUBJECT: Brazil's Natural Gas Output to Rise, but Challenges Remain

REF: SAO PAULO 0031; BRASILIA 1215

11. (SBU) Summary: The potential natural gas reserves found in Brazil's offshore pre-salt cluster could help boost domestic production and reduce Brazil's dependency on foreign natural gas, possibly as early as 2020. According to energy sector experts at a conference sponsored by Gas Energy, while the transition holds potential implications for Brazilian-Bolivian relations as well as a further solidification of Brazil's energy independence, challenges in infrastructure, distribution, and investment could impede Brazil's full utilization of these new resources. End Summary

-----  
Pre-salt Findings Could Reshape Natural Gas Sector  
-----

12. (SBU) Brazil probably will continue to depend heavily on Bolivian natural gas (NG) imports until substantial pre-salt NG deposits come on line. Natural gas imports from Bolivia account for about half of total internal demand, with the other half produced domestically. Econoff attended a November 4 industry seminar sponsored by Gas Energy, a private company that assesses the natural gas, oil and energy sectors in Brazil and the rest of Latin America, in Sao Paulo where experts indicated that natural gas demand declined from 61 to 44 cubic million meters per day (Mm???/d) in 2009 due to a slowdown in industrial production from the global economic crisis, but demand is expected to rise with the resumption of economic expansion in 2010. (Note: Sao Paulo's industrial complex is the most highly natural gas dependent part of the country, accounting for 38 percent of daily natural gas use. End Note.) Natural gas demand also declined in part due to plentiful rainfalls which allowed Brazil to maximize its predominant power source, hydropower, rather than compensating with more expensive natural gas.

13. (SBU)Many in the Brazilian energy sector have looked to move away from dependence on Bolivian gas supply since 2006 when Bolivia nationalized Petrobras investments in the sector(Reftels A&B). The September 2008 disruption in supply due to political protests in Bolivia further increased Brazilian determination to achieve some independence from Bolivian gas, however Brazil has a 20 year commitment to Bolivia to purchase a minimum of 24 million m????/d. To diversify its gas supply, Brazil has brought on line some new Liquefied Natural Gas (LNG) terminals and has acquired supply from Trinidad and Tobago.

14. (SBU)In continuing attempts to expand natural gas supply, over the long-term, Brazil is likely to gradually shift away from Bolivian gas imports to new domestic gas sources in the pre-salt deposits offshore of Sao Paulo and Rio de Janeiro states. Experts from the seminar, including Sylvie D'Apote of Gas Energy, stated that Brazil will begin producing a small amount of natural gas from the pre-salt finds in 2012, with daily production from the region probably reaching 60 Mm????/d by 2020, or about 39 percent of total expected NG supply for 2020. As a result, D'Apote expects imports from Bolivia will then account for only 19 percent of the total

SAO PAULO 00000688 002 OF 003

expected supply, with another 29 percent coming from already-developed fields, and the remaining 13 percent from imported LNG. According to the speakers' projections, domestic NG demand by 2020 will be around 95 percent of the total supply, leaving Brazil with a limited excess NG amount of about 8 Mm????/d. (Note: While the pre-salt fields appear to offer a significant potential source of natural gas, conference presenters did not address the logistical challenges of tapping into natural gas 210 miles from the Brazilian coast beneath 2 kilometers of water and 5 kilometers of sand, rock and salt. GOB officials however admit that the logistics present a real challenge to making the pre-salt gas reserves a viable energy supply. End Note).

-----

#### Infrastructure Challenges Ahead

-----

15. (SBU)Despite the bright outlook for Brazilian Natural Gas production, industry experts, D'Apote and Ricardo Pinto of Gas Energy, say infrastructure, distribution and competitiveness issues hamper increased adoption of domestic natural gas by industrial and commercial consumers. Most importantly, inadequate infrastructure to transport NG and poor distribution network interconnectivity increase costs for Brazilian consumers and have fostered chronic supply disruptions. At present, Brazil's three main regional markets, the South/Southeast (supplied primarily by imports from Bolivia), the North (supplied domestically), and the Northeast (supplied domestically) have only limited NG and LNG pipeline interconnectivity. According to Pinto and Marco Tavares of Gas Energy, Brazil plans to expand its NG infrastructure network from the current 7.7 thousand kilometers to 9.3 thousand kilometers, but the cost is expected to be high and funding remains uncertain.

-----

#### Regulatory Changes Needed

-----

¶6. (SBU) In addition to infrastructure and distribution challenges, industry experts such as Pinto and Tavares cite a lack of competition in the sector as another major impediment to expansion and cost-efficiency. Brazilian natural gas is currently sold at around \$15.58/million BTU compared to Bolivian gas prices of \$9.57/million BTU. Seminar panelist Tavares highlighted the need to increase competition and dismissed the Natural Gas Law approved in March 2009 as ineffective in reducing Petrobras' hold on the industry. Although a key objective of the law was to allow private companies to enter the market for gas transportation and storage, Petrobras remains the dominant player controlling all gas transportation infrastructure, most distributors, and marketing over 95 percent of the gas sold in Brazil. Additionally, Petrobras controls the supply chain of other energy products, such as oil, which may be used as substitutes to NG, further boosting the price of natural gas.

-----

SAO PAULO 00000688 003 OF 003

Comment

-----

¶7. (SBU) While Brazil will continue to depend on Bolivian gas to meet domestic demand for the immediate future, the country's natural gas production outlook appears promising as the pre-salt finds are expected to boost domestic output and diminish reliance on Bolivian imports over the next ten years, if Brazil is able to overcome the significant logistical challenges inherent in processing gas in the pre-salt environment. Nevertheless, as industry experts note, significant investments in infrastructure and distribution will be needed in addition to regulatory reform to attract the private investment necessary to successfully develop the new resources. With elections approaching, Petrobras' political clout, and the nationalistic tone of the current debate over pre-salt development legislation, near-term progress to broadly open the sector to private investment appears unlikely. End Comment.

¶8. (U) This cable was coordinated/cleared by US Embassy Brasilia and US Consulate Rio de Janeiro  
White